The following is the text of a report, prepared for the purpose of inclusion in this document received from the reporting accountants, Grant Thornton, Certified Public Accountants, Hong Kong.

Grant Thornton
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Member of Grant Thornton International Ltd

27 May 2008

The Directors
NetDragon Websoft Inc.
First Shanghai Capital Limited

Dear Sirs,

We set out below our report on the financial information regarding NetDragon Websoft Inc. (the "Company") and its subsidiaries (collectively referred to as the "Group") for each of the three years ended 31 December 2005, 2006 and 2007 (the "Relevant Years") for inclusion in the introduction document of the Company dated 27 May 2008 in connection with the listing by way of introduction of the shares of the Company on the Main Board (the "Main Board") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

The Company was incorporated in the Cayman Islands on 29 July 2004 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. Pursuant to a group reorganisation (the "Reorganisation") as further detailed in the Company's prospectus (the "Prospectus") dated 23 October 2007, the Company has since 18 May 2007 become the ultimate holding company of the subsidiaries now comprising the Group. The shares of the Company have been listed on the Growth Enterprise Market ("GEM") of the Stock Exchange since 2 November 2007.

On 1 November 2007, an aggregate of 95,600,000 new shares were issued by way of placement. On 9 November 2007, an additional 16,200,000 new shares were issued by way of another placement. The detailed movement of the share capital is set out in note 23 of this report. The Company has proposed to withdraw its listing from the GEM of the Stock Exchange so as to arrange its shares to be listed on the Main Board of the Stock Exchange.

The Group is principally engaged in online game development and operation and marketing of online games. At the date of this report, the Company has direct and indirect interests in the subsidiaries as set out in note 17, all of which are private companies (or, if incorporated or established outside Hong Kong, have substantially the same characteristics as a Hong Kong private company). All companies now comprising the Group have adopted 31 December as their financial year end date. We have acted as the auditors of the Company since its date of incorporation. The statutory financial statements of the subsidiaries established in the People's Republic of China except Hong Kong (the "PRC") were prepared in accordance with the relevant accounting principles and financial regulations applicable to these PRC subsidiaries. The names of the statutory auditors of these PRC subsidiaries are set out in note 17. No audited financial statements have been prepared for the subsidiaries newly incorporated in Hong Kong and established in the PRC. No audited financial statements have been prepared for other subsidiaries as there is no statutory audit requirement under their jurisdictions of incorporation.

For the purpose of this report, the directors of the Company have prepared the financial statements of the Company and of the Group for the Relevant Years, or from their respective dates of establishment, whichever is a short period, in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") which collective terms include all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") (the "HKFRSs Accounts").

The financial information set out in this report, including the consolidated income statements, consolidated statements of changes in equity and consolidated cash flow statements of the Group for the Relevant Years and the consolidated balance sheets of the Group and the balance sheets of the Company as at 31 December 2005, 2006 and 2007 together with the notes thereto (collectively the "Financial Information"), has been prepared based on the audited HKFRSs Accounts.

In preparing this report, no adjustments were considered necessary to restate the audited HKFRSs Accounts to conform with the accounting policies referred to in note 3 of Section II of this report, which are in compliance with HKFRSs.

Directors' Responsibilities

The directors of the Company are responsible for the preparation and true and fair presentation of the Financial Information in accordance with HKFRSs issued by the HKICPA. The directors of the respective companies now comprising the Group are responsible for the preparation and true and fair presentation of the respective financial statements. This responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and the true and fair presentation of the Financial Information, financial statements and management accounts that are free from material misstatements, whether due to fraud or error; selecting appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Reporting Accountants' Responsibilities

The HKFRSs Accounts have been audited by us in accordance with Hong Kong Standards on Auditing issued by the HKICPA.

It is our responsibility to form an independent opinion on the Financial Information for the Relevant Years and to report our opinion to you.

For the purpose of this report, we have carried out an independent examination of the Financial Information for the Relevant Years and have carried out such additional procedures as we consider necessary in accordance with the Auditing Guideline 3.340 "Prospectuses and the Reporting Accountant" issued by HKICPA.

Opinion

In our opinion, the Financial Information set out below, for the purpose of this report, gives a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2005, 31 December 2006 and 31 December 2007 and of the Group's results and cash flows for the Relevant Years.

I. FINANCIAL INFORMATION

CONSOLIDATED INCOME STATEMENTS

	Notes	2005	2006	2007
		Year ended 31 December		
		RMB'000	*RMB'000*	*RMB'000*
Revenue	7	35,119	122,061	645,214
Cost of revenue		(4,669)	(11,179)	(36,863)
Gross profit		30,450	110,882	608,351
Other revenue and gains	7	4,950	5,673	8,321
Selling and marketing expenses		(25,450)	(13,838)	(80,844)
Administrative expenses		(16,906)	(22,960)	(50,090)
Development costs	8	(15,464)	(12,835)	(37,253)
Other operating expenses		(8,501)	(15,377)	(21,404)
Operating (loss)/profit	8	(30,921)	51,545	427,081
Loss on disposal of an associate		—	(2)	—
(Loss)/Profit before income tax		(30,921)	51,543	427,081
Income tax credit/(expense)	11	1,721	(8,558)	(52,244)
(Loss)/Profit for the year		(29,200)	42,985	374,837
Attributable to				
Equity holders of the Company		(29,171)	42,856	374,854
Minority interests		(29)	129	(17)
		(29,200)	42,985	374,837
Dividends		—	—	295,162
		RMB cents	*RMB cents*	*RMB cents*
(Loss)/Earnings per share	13			
- Attributable to the equity holders of the Company				
- Basic		(8.31)	12.21	85.01
- Diluted		N/A	N/A	N/A

CONSOLIDATED BALANCE SHEETS

	Notes	At 31 December 2005 RMB'000	2006 RMB'000	2007 RMB'000
ASSETS AND LIABILITIES				
Non-current assets				
Property, plant and equipment	14	13,738	23,211	61,344
Land use rights	15	—	—	1,174
Interest in an associate	16	430	—	—
Available-for-sale financial asset	18	4,000	4,000	4,000
Deferred tax assets	27	6,046	201	54
		24,214	27,412	66,572
Current assets				
Investment in trading securities	18	4,599	851	—
Trade and other receivables	19	9,953	40,354	67,295
Amounts due from related parties	26(iii)	5,530	11,357	8,832
Tax recoverable		—	—	581
Term deposits with initial term of over three months	20	—	—	50,000
Cash and cash equivalents	21	15,277	66,322	1,651,380
		35,359	118,884	1,778,088
Current liabilities				
Trade and other payables	22	17,103	37,910	45,262
Amounts due to related parties	26(iii)	2,156	725	76
Income tax payable		345	2,954	29,940
		19,604	41,589	75,278
Net current assets		15,755	77,295	1,702,810
Total assets less current liabilities/Net assets		39,969	104,707	1,769,382
EQUITY				
Share capital	23	1,453	1,453	41,219
Reserves	25	38,516	103,125	1,728,051
Equity attributable to equity holders of the Company		39,969	104,578	1,769,270
Minority interests		—	129	112
Total equity		39,969	104,707	1,769,382

BALANCE SHEETS

	Notes	At 31 December 2005 *RMB'000*	2006 *RMB'000*	2007 *RMB'000*
ASSETS				
Non-current assets				
Investment in subsidiaries	17	—	—	167,871
Current assets				
Trade and other receivables	19	—	—	5,428
Amounts due from related parties	26(iii)	1,453	1,453	—
Amount due from a subsidiary	17	—	—	225,052
Cash and cash equivalents	21	—	—	1,317,532
		1,453	1,453	1,548,012
Current liabilities				
Trade and other payables	22	—	—	7,402
Amounts due to subsidiaries	17	—	—	2,967
		—	—	10,369
Net current assets		1,453	1,453	1,537,643
Total assets less current liabilities/Net assets		1,453	1,453	1,705,514
EQUITY				
Share capital	23	1,453	1,453	41,219
Reserves	25(a)	—	—	1,664,295
Total equity		1,453	1,453	1,705,514

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to equity holders of the Company											
	Share capital RMB'000	Share premium RMB'000 *(note 25(b)(i))*	Capital contribution RMB'000	Capital redemption reserve RMB'000	Capital reserve RMB'000 *(note 25(b)(ii))*	Statutory reserves RMB'000 *(note 25(b)(iii))*	Translation reserve RMB'000	Dividend reserve RMB'000	Retained profits RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
At 1 January 2005	1,453	16,267	—	—	11,596	2,676	177	—	37,156	69,325	29	69,354
Exchange difference arising on translation of overseas operations	—	—	—	—	—	—	(185)	—	—	(185)	—	(185)
Expense recognised directly in equity	—	—	—	—	—	—	(185)	—	—	(185)	—	(185)
Loss for the year	—	—	—	—	—	—	—	—	(29,171)	(29,171)	(29)	(29,200)
Total recognised income and expense for the year	—	—	—	—	—	—	(185)	—	(29,171)	(29,356)	(29)	(29,385)
At 31 December 2005 and 1 January 2006	1,453	16,267	—	—	11,596	2,676	(8)	—	7,985	39,969	—	39,969
Exchange difference arising on translation of overseas operations	—	—	—	—	—	—	(2)	—	—	(2)	—	(2)
Expense recognised directly in equity	—	—	—	—	—	—	(2)	—	—	(2)	—	(2)
Profit for the year	—	—	—	—	—	—	—	—	42,856	42,856	129	42,985
Total recognised income and expense for the year	—	—	—	—	—	—	(2)	—	42,856	42,854	129	42,983
Capital received in advance *(note 25(b)(i))*	—	—	21,755	—	—	—	—	—	—	21,755	—	21,755
Appropriations	—	—	—	—	—	4,092	—	—	(4,092)	—	—	—
At 31 December 2006 and 1 January 2007	1,453	16,267	21,755	—	11,596	6,768	(10)	—	46,749	104,578	129	104,707
Exchange difference arising on translation of overseas operations	—	—	—	—	—	—	(10,797)	—	—	(10,797)	—	(10,797)
Expense recognised directly in equity	—	—	—	—	—	—	(10,797)	—	—	(10,797)	—	(10,797)
Profit for the year	—	—	—	—	—	—	—	—	374,854	374,854	(17)	374,837
Total recognised income and expense for the year	—	—	—	—	—	—	(10,797)	—	374,854	364,057	(17)	364,040
Issue of shares by a subsidiary# *(note 25(b)(i))*	—	69,984	(21,755)	—	170	—	—	—	—	48,399	—	48,399
Issue of shares by the Company *(note 23(iv)&(v))*	2,053	—	—	—	(1,820)	—	127	—	—	360	—	360
Dividend declared *(note 12)*	—	—	—	—	—	—	—	—	(79,069)	(79,069)	—	(79,069)
Issue of new shares by the Company upon listing *(note 23(ix))*	7,046	1,183,554	—	—	—	—	—	—	—	1,190,600	—	1,190,600
Issue of new shares by the Company upon capitalisation issue *(note 23(viii))*	29,481	(29,481)	—	—	—	—	—	—	—	—	—	—
Issue of new shares by the Company upon exercise of over-allotment options *(note 23(x))*	1,194	200,559	—	—	—	—	—	—	—	201,753	—	201,753
Share issue expenses	—	(59,839)	—	—	—	—	—	—	—	(59,839)	—	(59,839)
Repurchase and cancellation of shares *(note 23(xi))*	(8)	(1,561)	—	8	—	—	—	—	(8)	(1,569)	—	(1,569)
Final proposed dividend *(note 12)*	—	—	—	—	—	—	—	216,093	(216,093)	—	—	—
Appropriations	—	—	—	—	—	54,448	—	—	(54,448)	—	—	—
At 31 December 2007	41,219	1,379,483	—	8	9,946	61,216	(10,680)	216,093	71,985	1,769,270	112	1,769,382

\# Holding company of the Group before completion of the Group reorganisation

CONSOLIDATED CASH FLOW STATEMENTS

	Year ended 31 December		
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Cash flows from operating activities			
(Loss)/Profit before income tax	(30,921)	51,543	427,081
Adjustments for:			
Gain on disposal of an available-for-sale financial assets	(54)	—	—
Loss on disposal of an associate	—	2	—
Fair value gain on investment in trading securities	—	(383)	(106)
Interest income	(392)	(614)	(7,008)
Amortisation of land use rights	—	—	5
Depreciation of property, plant and equipment	3,958	4,457	9,341
Write off of property, plant and equipment	517	795	—
Loss on disposal of property, plant and equipment	112	466	20
Impairment on receivables	2	416	541
Foreign exchange differences	443	287	(8,171)
Operating (loss)/profit before changes in working capital	(26,335)	56,969	421,703
Increase in trade and other receivables	(3,010)	(30,817)	(27,314)
(Increase)/Decrease in amounts due from related parties	(1,497)	(5,827)	1,072
Increase in trade and other payables	10,121	20,807	7,352
Increase/(Decrease) in amounts due to related parties	1,895	(1,431)	(649)
Cash (used in)/generated from operations	(18,826)	39,701	402,164
Income tax paid	(6)	(104)	(25,692)
Net cash (used in)/generated from operating activities	(18,832)	39,597	376,472

	Year ended 31 December		
	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Cash flows from investing activities			
Interest received	392	614	6,840
Proceeds from disposal of an available-for-sale financial assets	630	—	—
Proceeds from disposals of an associate	—	428	—
Proceeds from disposals of property, plant and equipment	243	526	10
Increase in term deposits with initial term of over three months	—	—	(50,000)
Net cash (used in)/generated from investment in trading securities	(4,599)	4,131	957
Investment in an associate	(430)	—	—
Purchase of land use rights	—	—	(1,179)
Purchase of property, plant and equipment	(3,421)	(15,717)	(47,504)
Net cash used in investing activities	(7,185)	(10,018)	(90,876)
Cash flows from financing activities			
Proceeds from shares issued by the Company *(note 23(ii), (iv), (ix) & (x))*	—	—	1,394,166
Proceeds from shares issued by a subsidiary *(note 25(b)(i))*	—	21,755	48,399
Dividends paid *(note 12)*	(3,465)	—	(79,069)
Share issue expenses	—	—	(59,839)
Payment for repurchase of shares *(note 23(xi))*	—	—	(1,569)
Net cash (used in)/generated from financing activities	(3,465)	21,755	1,302,088
Net (decrease)/increase in cash and cash equivalents	(29,482)	51,334	1,587,684
Cash and cash equivalents at beginning of year	45,393	15,277	66,322
Effect of foreign exchange rate change	(634)	(289)	(2,626)
Cash and cash equivalents at end of year	15,277	66,322	1,651,380

II. NOTES TO THE FINANCIAL INFORMATION

1. GENERAL INFORMATION

NetDragon Websoft Inc. (the "Company") was incorporated in the Cayman Islands on 29 July 2004 as an exempted company with limited liability. The registered office of the Company is situated at Scotia Centre, 4th Floor, P.O. Box 2804, George Town, Grand Cayman, Cayman Islands and its principal place of business is situated at 58 Hot Spring Branch Road, Fuzhou, Fujian, the People's Republic of China except Hong Kong (the "PRC"). The Company's shares have been listed on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 2 November 2007.

The Company and its subsidiaries (collectively, the "Group") are principally engaged in online game development and operation and marketing of online games.

The operations of the Group were initially conducted through Fujian NetDragon Websoft Co., Ltd. ("NetDragon (Fujian)"), a limited liability company established in the PRC by certain shareholders of the Company on 25 May 1999. NetDragon (Fujian) is legally owned by the controlling shareholders of the Company who are PRC citizens.

The existing PRC law and regulations restrict foreign investment in businesses providing internet content and information services in the PRC, which included activities and services operated by NetDragon (Fujian). As a wholly-owned foreign enterprise, the Company's wholly owned subsidiary, Fujian TQ Digital Inc ("TQ Digital"), does not have the requisite licenses to provide internet content and information services in the PRC.

Accordingly, the Group operated pursuant to a cooperation arrangement between TQ Digital and NetDragon (Fujian) prior to 1 January 2007. Under such cooperation arrangement, TQ Digital was responsible for game software development and provision of the relevant technical services while NetDragon (Fujian) was responsible for the overall operation of the relevant games. In addition, each of TQ Digital and NetDragon (Fujian) was entitled to use the trademarks, copyrights and other intellectual property rights of the other party. Revenue generated from the operations of the games was collected by TQ Digital on behalf of NetDragon (Fujian). Pursuant to the cooperation arrangement, TQ Digital would then return 30% of the total revenue received to NetDragon (Fujian), representing the revenue attributable to the operations of the games, and retain the remaining 70% of the total revenue, representing the games license fee.

In preparation for the listing on GEM of the Stock Exchange and with a view to offer further protection to the interests of the Company and the shareholders as a whole by means of contractual arrangements, TQ Digital and NetDragon (Fujian) and its equity holders entered into certain agreements (the "Structure Contracts"), which superseded the cooperation arrangements between TQ Digital and NetDragon (Fujian) effective from 1 January 2007. Under the Structure Contracts, the decision-making rights and operating and financing activities of NetDragon (Fujian) and its subsidiary, Shanghai Tiankun Digital Technology Ltd. ("NetDragon (Shanghai)"), are ultimately controlled by TQ Digital. TQ Digital is also entitled to substantially all of the operating profits generated by NetDragon (Fujian) and NetDragon (Shanghai) under these arrangements.

Despite the lack of shareholding in NetDragon (Fujian), the agreements entered into by TQ Digital and the equity holders of NetDragon (Fujian) confer TQ Digital the power and authority to exercise control over NetDragon (Fujian). Pursuant to the agreements:

- all the equity holders of NetDragon (Fujian) have granted irrevocable proxy to TQ Digital or a nominee designated by TQ Digital (which will likely be a director of TQ Digital) to exercise all their voting right in the capacity of shareholders of NetDragon (Fujian);
- the equity holders of NetDragon (Fujian) have agreed not to enter into any transaction that may materially affect the assets, liabilities, equity or operations of NetDragon (Fujian) without the prior written consent of TQ Digital;

- the equity holders of NetDragon (Fujian) have agreed not to transfer, sell, pledge, dispose of or create any encumbrance on their equity interest in NetDragon (Fujian) without the prior written consent of TQ Digital;

- NetDragon (Fujian) will not distribute any dividend; and

- the equity holders of NetDragon (Fujian) have pledged their equity interest in NetDragon (Fujian) to TQ Digital as a security against its payment obligations and other obligations and covenants under the Structure Contracts.

The Structure Contracts taken as a whole allow TQ Digital to govern the financial and operating policies of NetDragon (Fujian) and TQ Digital is able to obtain substantially all economic benefits from the activities conducted by NetDragon (Fujian). Accordingly, the directors of the Company regard NetDragon (Fujian) and NetDragon (Shanghai) as the subsidiaries of the Group as defined under Hong Kong Accounting Standard 27 "Consolidated and Separate Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

Further details of the Group reorganisation prior to the listing of the Company's shares on the GEM of the Stock Exchange, including further details of the Structure Contracts, are disclosed in the Company's prospectus dated 23 October 2007.

In view of the new enterprise income tax law adopted by the National People's Congress of the PRC on 16 March 2007, a wholly owned foreign enterprise, Fujian TQ Online Interactive Inc. ("TQ Online") has been established through Glory More Limited ("Glory More"), one of the wholly owned subsidiaries of NetDragon Websoft Inc. ("NetDragon (BVI)") and incorporated in Hong Kong, to gradually substitute TQ Digital in the Group's operation in order to maximise the tax benefits to the Group under the new tax law. Consequentially, TQ Online has entered into the Structure Contracts with NetDragon (Fujian) on 16 May 2008 under which any new versions of the Group's existing games and new games will be operated by TQ Online and NetDragon (Fujian).

As the Company, NetDragon (BVI), TQ Digital, NetDragon Websoft Inc. ("NetDragon (USA)"), NetDragon (Fujian), NetDragon (Shanghai), NetDragon Websoft (Hong Kong) Limited ("NetDragon HK"), Glory More and TQ Online were ultimately controlled by the same group of parties before and after the formation of the Group and the control is not transitory, the Financial Information is thereby prepared using the principles of merger accounting as set out in Accounting Guideline 5 "Merger accounting under common control combination" issued by the HKICPA.

The Financial Information on page I-4 to I-52 of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the HKICPA. The Financial Information also complies with the applicable disclosure requirements of the Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the Stock Exchange.

2. ADOPTION OF NEW AND AMENDED HKFRSs

The Group has adopted all new and revised HKFRSs which are first effective for the year and relevant to the Group. Those new and revised HKFRSs effective for the accounting periods beginning on 1 January 2007 have been adopted consistently throughout the three years ended 31 December 2007.

The Group has not applied the following new or revised HKFRSs that have been issued but are not yet effective:

HKAS 1 (revised)	Presentation of Financial Statements [3]
HKAS 27 (revised)	Consolidated and Separate Financial Statements[5]
HKAS 23 (revised)	Borrowing Costs [3]
HKFRS 3 (revised)	Business Combinations[5]
HKFRS 8	Operating Segments [3]

HK(IFRIC)-INT 11	HKFRS 2 — Group and Treasury Share Transactions [1]
HK(IFRIC)-INT 12	Service Concession Arrangements [2]
HK(IFRIC)-INT 13	Customer Loyalty Programmes [4]
HK(IFRIC)-INT 14	HKAS 19 — The Limit on Defined Benefit Assets, Minimum Funding Requirements and their intention [2]

1 Effective for annual periods beginning on or after 1 March 2007

2 Effective for annual periods beginning on or after 1 January 2008

3 Effective for annual periods beginning on or after 1 January 2009

4 Effective for annual periods beginning on or after 1 July 2008

5 Effective for annual periods beginning on or after 1 July 2009

Amendment to HKAS 1 Presentation of Financial Statements:

This amendment affects the presentation of owner changes in equity and introduces a statement of comprehensive income. Preparers will have the option of presenting items of income and expense and components of other comprehensive income either in a single statement of comprehensive income with subtotals or in two separate statements (a separate income statement followed by a statement of other comprehensive income). The management is in the process of making an assessment of what the impact of this amendment is expected to be in the period of initial application. So far it has concluded that the adoption of this amendment does not affect the financial position and results of the Group, but will give rise to additional disclosures.

The Group is in the process of assessing the impact of other new or revised HKFRSs upon initial application. The Group anticipates that these new or revised HKFRSs are unlikely to have any material impact on the Group's Financial Information.

It should be noted that accounting estimates and assumptions have been used in preparing the Financial Information. Although these estimates are based on management's best knowledge and judgement of current events and actions, actual results may ultimately differ from those estimates and assumptions. The areas where assumptions and estimates are significant to the Financial Information or areas involving higher degree of judgement or complexity are set out in note 4 "Critical Accounting Estimates and Judgements".

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The Financial Information have been prepared under the historical cost convention except for certain financial assets which are stated at fair value. The measurement bases are fully described in the accounting policies below.

(b) Merger accounting

The net assets of the combining entities or businesses are combined using the existing book values from the controlling parties' perspective. No amount is recognised as consideration for goodwill or excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of common control combination. The Financial Information includes the results of each of the combining entities or businesses from the date of incorporation/establishment or since the date when the combining entities or businesses first came under the common control, where this is a shorter period, regardless of the date of the common control combination. All significant intra-group transactions, balances and unrealised gains on transactions have been eliminated on combination. Unrealised losses are also eliminated unless the transactions provide evidence of an impairment of the asset transferred.

(c) **Subsidiaries**

A subsidiary is an entity (including special purpose entity) over which the Group has power to govern its financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights, so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The financial statements of subsidiaries are included in the Financial Information from the date that control commences until the date that control ceases.

Purchase method of accounting is used to account for the acquisition of subsidiaries by the Group, except for those acquisitions which qualify as a common control combination, which are accounted for using merger accounting as detailed in note 3(b).

All the material intra-group transactions, balances and unrealised gains on transactions between Group companies are eliminated in preparing the Financial Information. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

In the Company's balance sheet, the investment in subsidiary is stated at cost less provision for impairment losses, if any. The result of subsidiary is accounted for by the Company on the basis of dividends received and receivable.

(d) **Associates**

An associate is an entity over which the Group is able to exercise significant influence, generally accompanying a shareholding of between 20% and 50% of the voting rights. An investment in an associate is accounted for in the Financial Information under the equity method of accounting and is initially recorded at cost and adjusted thereafter for the post-acquisition changes in the Group's share of the associate's net assets less any identified impairment losses. The Financial Information include the Group's share of the post-acquisition, post-tax results of the associate for the year.

(e) **Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment losses.

The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in future economic benefits expected to be obtained from the use of the item of property, plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on a straight-line basis to write off the cost of each item of property, plant and equipment over its estimated useful life, after taking account of its estimated residual value. The principal annual rates used for this purpose is as follows:

Buildings	4.75%
Leasehold improvements	shorter of the lease terms and 20%
Computer and office equipment	19% - 20%
Motor vehicles	19%

Useful lives, residual values and depreciation methods are reviewed and adjusted, if appropriate, at each financial year end.

An item of property, plant and equipment is derecognised upon disposal or when no further economic benefits are expected to arise from the continued use of the item. Any gain or loss arising on derecognising the item (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the period the item is derecognised.

(f) **Operating leases**

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

Payment for obtaining land use rights is considered as operating leases payment are initially stated at cost and subsequently charged to income statement over the period of the right using the straight-line method.

(g) **Foreign currencies**

Items included in the financial statements of each of the Group entities are measured using the currency of the primary economic environment in which the Group entity operates (i.e. the "functional currency"). The Financial Information is presented in Renminbi ("RMB"), which is the functional and presentation currency of the Company and most of its subsidiaries.

In preparing the financial statements of individual Group entity, transactions in currencies other than the Group entity's functional currency (i.e. foreign currency) are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are not translated.

For the purpose of preparing the Financial Information, the assets and liabilities of the subsidiaries in which the functional currency is not RMB are translated into RMB at the exchange rates ruling at the balance sheet date, and their income statements are translated into RMB at the weighted average exchanges rate for the year. Foreign exchange gains and losses arising thereon are dealt with in the translation reserve. Such translation differences are recognised in the income statement in the period in which the foreign operation is disposed of.

(h) **Impairment of non-financial assets**

Where an indication of impairment exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount.

An asset's recoverable amount is the higher of its fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Where the carrying amount of an asset/a cash-generating unit exceeds its recoverable amount, the asset/cash-generating unit is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset/cash-generating unit. An impairment loss is charged to the income statement in the period in which it arises.

A previously recognised impairment loss on non-financial assets other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset/cash-generating unit, provided the increased amount of the asset/cash-generating unit does not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset/cash-generating unit in prior years. Such reversal is credited to the income statement in the period in which it arises.

(i) **Financial assets**

The Group's financial assets are classified into financial assets at fair value through profit or loss, available-for-sale financial assets and loans and receivables. Management determines the classification of its financial assets at initial recognition depending on the purpose for which the financial assets were acquired and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All financial assets are recognised when, and only when, the Group becomes a party to the contractual provisions of the instrument. All regular way purchases and sales of financial assets are recognised on trade date. Regular way purchase or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. Derecognition of financial assets occurs when the rights to receive cash flows from the investments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred.

(i) *Financial assets at fair value through profit or loss*

Financial assets held for trading and financial assts designated upon initial recognition as at fair value through profit or loss are classified as financial assets at fair value through profit or loss. Financial assets are treated as held for trading if they are acquired for the purpose of sale in the near term. Financial assets at fair value through profit or loss are subsequently measured at fair value with changes in fair value being charged to the income statement. In the Financial Information, securities held for trading that are categorised as financial assets at fair value through profit or loss are presented as "Investment in trading securities" under current assets in the balance sheet.

(ii) *Loans and receivables*

Loans and receivables including trade and other receivables and amounts due from related parties are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade receivables are included in current assets. Other loans and receivables are included in current assets unless they are expected not to be realised within 12 months after the balance sheet date and in such case, they are classified as non-current assets in the balance sheet.

Loans and receivables are subsequently carried at amortised cost using the effective interest method, less any impairment losses. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction cost. Changes in value of loans and receivables through the amortisation process are recognised in the income statement.

(iii) *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivative financial assets that are either designated or not classified in any other categories of financial assets. They are included in non-current assets unless management intends to dispose of the assets within 12 months from the balance sheet date.

After initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognised as a separate component of equity until they are disposed of or determined to be impaired, at which time the cumulative loss previously recognised in equity is removed from equity and recognised in the income statement.

For available-for-sale equity investment which fair value cannot be measured reliably because (1) the variability in the range of reasonable fair value estimates is significant for that investment and (2) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such investment is stated at cost less any impairment losses.

(j) **Impairment of financial assets**

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If such evidence exists, the impairment loss is measured and recognised as follows:

(i) *Loans and receivables*

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The amount of impairment loss is recognised in the income statement of the period in which the impairment occurs. In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the loans and receivables is directly reduced by any identified amount of impairment. Impaired debts are derecognised when they are assessed as uncollectible.

If, in subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent that it does not result in a carrying amount of the financial asset exceeding what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in the income statement of the period in which the reversal occurs.

(ii) *Available-for-sale financial assets measured at fair value*

If any such evidence exists for available-for-sale financial assets, the cumulative loss, measured as the difference between the asset's acquisition cost and the current fair value less any impairment loss on that asset previously recognised in the income statement, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the income statement.

(iii) *Available-for-sale financial assets measured at cost*

If there is objective evidence that an impairment loss on an unquoted investment that is not carried at fair value has been incurred, the amount of impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed in subsequent period in which the reversal occurs.

(k) **Cash and cash equivalents**

Cash and cash equivalents consist of cash on hand and at bank, demand deposits with banks, cash deposited with online payment service provider which can be readily withdrawn and short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(l) **Financial liabilities**

Financial liabilities include trade and other payables as well as amounts due to related parties which are initially stated at fair value and subsequently carried at amortised cost using the effective interest method. Changes in value of financial liabilities through the amortisation process are recognised in the income statement.

(m) **Provisions and contingent liabilities**

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation. When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(n) **Income tax**

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current year and prior periods are measured at the amounts expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences, unused tax losses available to be carried forward as well as other unused tax credits, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, the unused tax credits and the unused tax losses can be utilised.

Deferred tax assets and liabilities are not recognised if temporary differences arise from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction, affect neither the accounting profit nor taxable profit or loss.

Deferred tax liabilities in respect of taxable temporary differences associated with an investment in subsidiaries are not recognised where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profits will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax is calculated at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

(o) **Revenue recognition**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before the revenue is recognised:

(i) The Group sells pre-paid game cards to distributors and online game players. With the pre-paid game cards, online game players can credit their online game accounts with game points which can be used for the consumption of certain online games of the Group or for purchasing virtual products or premium features for the consumption of other online games of the Group which are free-to-play. The game users can also credit their online user accounts directly. Such income received is deferred and recorded as deferred income under current liabilities and would be recognised as revenue (i.e. online game revenue) upon the actual usage of the game points. Revenue recognised in respect of operating the online games is net of discounts, business tax and other related taxes and charges.

(ii) Game development fee which arises from developing online games for customers is recognised as revenue by reference to the stage of completion of developing the respective online game. As game development fee is non-recurring revenue and earned from developing online games for outsider which is not a principal activity of the Group, such fee income is recognised as other revenue.

(iii) Interest income is recognised on a time-proportion basis using the effective interest method.

(iv) Grants from government are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as other revenue and presented as such over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

(p) **Cost of revenue**

Costs of revenue consist primarily of rental and maintenance fees of computer equipment and software, fees in respect of internet services, handling charges for online payment services, manufacturing costs for pre-paid game cards and depreciation, which are recognised in the income statement upon utilisation of the relevant services or when the relevant costs are incurred, as appropriate.

(q) **Development costs**

Expenditure incurred on projects to develop new products is charged to income statement as incurred unless the Group can demonstrate the technical feasibility of completing the projects so that the asset generated will be available for use or sale, its intention to complete the projects and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. In such case, development expenditure is capitalised and deferred as intangible asset, and is amortised over its estimated useful life.

(r) **Pension obligations**

In accordance with the rules and regulations in the PRC, the employees of the entities established in the PRC are required to participate in defined contribution retirement benefits plans organised by regional governments. The regional governments undertake to assume the retirement benefit obligations of all existing and future retired employees payable under the plan described above. Contributions to these plans are expensed as incurred and other than these monthly contributions, the Group has no further obligation for the payment of retirement benefits of its employees. The assets of these plans are held separately from those of the Group in an independent fund managed by the PRC government.

The Group's contributions to the defined contribution retirement benefit plan are not reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

(s) **Share capital**

Ordinary shares and non-redeemable preferred shares with discretionary dividends are classified as equity. Any transaction costs associated with the issuing of shares are deducted from share premium to the extent they are incremental costs directly attributable to the equity transactions.

(t) **Dividends**

Dividends proposed by the directors are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the equity holders in a general meeting. When these dividends have been approved by the equity holders and declared, they are recognised as a liability.

(u) **Related parties**

A party is considered to be related to the Group if:

(i) the party, directly or indirectly through one or more intermediaries, (1) controls, is controlled by, or is under common control within, the Group; (2) has an interest in the Group that gives it significant influence over the Group; or (3) has joint control over the Group;

(ii) the party is a member of the key management personnel of the Group or its parent;

(iii) the party is a close member of the family of any individual referred to in (i) or (ii);

(iv) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (ii) or (iii); or

(v) the party is a post-employment benefit plan for the benefit of the employees of the Group, or of any entity that is a related party of the Group.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the process of applying the Group's accounting policies, which are described in note 3, management has made various estimates and judgements which are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Estimates and judgements are continually evaluated. The key source of estimation uncertainty and accounting judgements that result in significant risk of causing a material adjustment to the carrying amount of assets and liabilities in the next financial year or significantly affect the amounts recognised in the Financial Information are discussed below:

(i) *Online game revenue recognition*

Online game revenue is recognised based on the actual consumption of the relevant game points. Income received in respect of unutilised game points including those arising from unactivated pre-paid game cards is recognised as deferred income. Online game income received is net of discounts given to certain distribution and payment channels. The amount of deferred income arising from unactivated pre-paid game cards is extracted from the accounting system of the Group. As to the amount of deferred income in respect of other unutilised game points, management's estimation is required in determining the average sales value of these unutilised game points as discounts given are different for different sales channels.

In assessing the amount of average sales value for the unutilised game points, management considers the discount rate applicable to each of the distribution and payment channels and the mix of income received via different distribution and payment channels. Based on these factors, management determines an average discount rate which gives rise to the best estimate of the discount given to those unutilised game points at year end. The average sales value of each game point is then determined by factoring the average discount rate to the face value of the game point. If the actual sales value of the unutilised game points differs from management's estimates, the amount of deferred income as well as online game revenue recognised would be affected.

(ii) *Subsidiary*

As detailed in note 1, NetDragon (Fujian) and NetDragon (Shanghai) are accounted for as subsidiaries as a consequence of the Structure Contracts. Significant judgements have been exercised by the management in assessing and concluding that NetDragon (Fujian) and NetDragon (Shanghai) are subsidiaries of the Group.

(iii) *Useful lives of property, plant and equipment*

The Group's management determines the estimated useful lives for the property, plant and equipment of the Group. This estimate is based on the historical experience of the actual useful lives of the relevant assets of similar nature and functions. The estimated useful lives could be different as a result of technical innovations which could affect the related depreciation charges included in income statement.

(iv) *Impairment of receivables*

The Group's management determines the provision for impairment of receivables. This estimate is based on the credit history of the customers and other debtors and the current market condition. Management will reassess the provision at each balance sheet date. The Group's estimates may be inaccurate and any changes in estimates would affect profit or loss in future years.

(v) *Estimates of current and deferred tax*

The Group is subject to taxation in various jurisdictions. Significant judgement is required in determining the amount of provision for taxation and the timing of payment of the related taxation. Where the final tax outcome is different from the amounts that were initially recorded, such differences would impact the income and deferred tax provisions in the period in which such determination were made.

5. FINANCIAL RISK MANAGEMENT AND CAPITAL MANAGEMENT

5.1 *Financial risk management*

The Group is exposed to a variety of financial risks: market risk (including foreign currency risk, interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management focuses on unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. Risk management is carried out by key management under the policies approved by the board of directors. The Group does not have written risk management policies. However, the board of directors meet regularly and cooperate closely with key management to identify and evaluate risks and to formulate strategies to manage financial risks.

(a) **Market risk**

(i) *Foreign exchange risk*

Most of the subsidiaries' financial currency is RMB since majority of the revenues of the Group are derived from operations in the PRC. RMB is not freely convertible into other foreign currencies and conversion of RMB into foreign currencies is subject to rules and regulations of foreign exchange control promulgated by the PRC government. The Group also has operations in the United States of America ("USA") and the business transactions conducted there during the years were mainly denominated and settled in US dollars, which is the functional currency of the relevant subsidiary. The exposure in exchange rate risk mainly arises from fluctuations on foreign currencies against the functional currency of the relevant Group entities. The Group currently does not have hedging policy in respect of the foreign currency risk. However, management monitors the related foreign currency risk exposure closely and will consider hedging significant foreign currency risk exposure should the need arises.

Based on the market conditions as at 31 December 2007, the Group determined that it is reasonably possible for RMB to strengthen/weaken by 5% against USD and HKD in the coming twelve months. If RMB had strengthened/weakened by 5% against USD and HKD with all other variables held constant, the Group's profit after tax and retained earnings would have changed mainly as a result of foreign exchange gains/losses on conversion of RMB denominated dividend into HKD for distribution to overseas investors and settlement of outstanding foreign currency denominated monetary items. Details of the changes are as follows:

	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Profit for the year increase/(decrease)			
- Strengthened 5%	248	24	10,515
- Weakened 5%	(261)	(25)	(11,041)

The change in foreign exchange rates do not affect the Company's and the Group's other components of equity.

(ii) *Interest rate risk*

The Group has no external borrowing. The Group is exposed to cash flow interest rate risk through the impact of rate changes on interest-bearing financial assets, mainly the cash and cash equivalents (note 21). However, the Group's income and operating cash flows are substantially independent of changes in market interest rates. Management will consider hedging significant interest rate exposure should the need arise.

Based on the market conditions as at 31 December 2007, the Group determined that it is reasonably possible for interest rates on cash and cash equivalents to strengthen/weaken by 50 basis points in the coming twelve months. If interest rates on cash and cash equivalents had been 50 basis points higher/lower with all other variables held constant, the profit after tax and retained earnings would have changed mainly as a result of higher/lower interest income on floating rate financial assets. Details of the changes are as follows:

	The Group			**The Company**		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Profit for the year increase/(decrease)						
- 50 basis points higher	76	331	8,506	—	—	6,588
- 50 basis points lower	(76)	(331)	(8,506)	—	—	(6,588)

The change in interest rates do not affect the Company's and the Group's other components of equity.

(b) **Credit risk**

Credit risk arises from term deposits with initial term of over three months, cash and cash equivalents, trade receivables, other receivables and amounts due from related parties. The Group limits its exposure to credit risk by rigorously selecting the counterparties. The Group's exposure to credit risk is summarised as follows:

	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Term deposits with initial term of over three months	—	—	50,000
Cash and cash equivalents	15,277	66,322	1,651,380
Trade receivables	1,131	6,200	26,940
Other receivables	2,206	18,837	6,140
Amounts due from related parties	5,530	11,357	8,832

The carrying amount of term deposits with initial term of over three months, cash and cash equivalents, trade receivables, other receivables and amounts due from related parties represent the Group's maximum exposure to credit risk.

Credit risk on term deposits with initial term of over three months and cash and cash equivalents are mitigated as cash is deposited in banks with high credit rating and reputable online payment service provider. Credit risk on trade receivables, other receivables and amounts due from related parties is minimised as the Group performs ongoing credit evaluation on the financial condition of its debtors and tightly monitors the ageing of the receivable balances. Follow up action is taken in case of overdue balances. In addition, management reviews the recoverable amount of the receivables individually or collectively at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts.

None of the Group's financial assets are securitised by collateral or other credit enhancements.

(c) **Liquidity risk**

Management of the Group aims at maintaining sufficient level of cash and cash equivalents to finance the Group's operations and expected expansion. The Group's primary cash requirements include payments for operating expenses and additions or upgrades of property, plant and equipment. The Group finances its working capital requirements mainly by the funds generated from operations.

The Group's financial liabilities (including trade and other payables and amounts due to related parties) will be settled within 12 months from the respective reporting date. The Group manages liquidity risk by forecasting the amount of cash required and monitoring the working capital of the Group to ensure that all liabilities due and known funding requirements could be met. Based on the assessment of the management, liquidity risk encountered by the Group is minimal.

5.2 ***Fair value estimation***

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. The fair value of debt securities is determined using the method of estimated discounted cash flows.

The carrying value of trade and other receivables, amounts due from related parties, trade and other payables, amounts due to related parties, cash equivalents and term deposits with initial term of over three months are assumed to approximate their fair values due to the short-term maturity of these balances.

5.3 ***Capital management***

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, to maintain an optimal capital structure to reduce the cost of capital and to support the Group's stability and growth.

The Group actively and regularly reviews and manages its capital structure to ensure optimal capital structure and shareholder returns, taking into consideration the future capital requirements of the Group. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, issue new shares or return capital to shareholders.

Management regards total equity as capital. The amount of capital as at 31 December 2005, 2006 and 2007 amounted to RMB39,969,000, RMB104,707,000 and RMB1,769,382,000, respectively, which the management considers as optimal having consider the projected capital expenditures and the projected strategic investment opportunities.

The details of the total equity of the Group as at 31 December 2005, 2006 and 2007 are as follows:

	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Share capital	1,453	1,453	41,219
Reserves	38,516	103,125	1,728,051
Equity attributable to equity holders of the Company	39,969	104,578	1,769,270
Minority interests	—	129	112
Total equity	39,969	104,707	1,769,382

6. SEGMENT INFORMATION

Based on risks and returns, the directors of the Company consider that the primary reporting format of the Group is by business segment. The directors consider that there is only one business segment, being online game development and operation and marketing of those online games. Therefore no further information about business segment is presented.

Geographical segment is the secondary reporting format of the Group. In determining the Group's geographical segments, revenue is attributed to the segments based on the location where services are provided and assets and capital expenditure are attributed to the segments based on the location of the assets. Unallocated assets mainly comprise available-for-sale financial assets, deferred tax assets, investment in trading securities, amounts due from related parties and amount due from a PRC entity, Gulun Holdings Limited (高能控股有限公司) (note 19(ii)).

The Group's turnover analysed by geographical markets during the Relevant Years are presented below:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
PRC	14,514	80,413	524,652
USA	18,332	40,889	117,030
Unallocated	2,273	759	3,532
	35,119	122,061	645,214

The carrying amount of segment assets and capital expenditure, which represents additions to property, plant and equipment, analysed by geographical markets is presented below:

		Segment assets	
	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
PRC	29,736	75,702	481,910
USA	4,477	9,374	24,386
Hong Kong	4,755	30,311	1,324,896
Unallocated	20,605	30,909	13,468
	59,573	146,296	1,844,660

		Capital expenditure	
	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
PRC	3,363	15,605	47,440
USA	58	112	64
	3,421	15,717	47,504

7. REVENUE AND GAINS

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Revenue — turnover			
Online game revenue	35,119	122,061	645,214
Other revenue and gains			
Game development fee	2,963	2,157	—
Government grants (note)	470	590	735
Interest income on bank balances stated at amortised cost classified as at fair value through profit or loss	392	614	7,008
Fair value gain on investment in trading securities	—	383	106
Others	1,125	1,929	472
	4,950	5,673	8,321
	40,069	127,734	653,535

Note: Government grants were received from the PRC government for subsidising the Group in conducting projects relating to software or technology development. There are no unfulfilled conditions or contingencies relating to these grants.

8. OPERATING (LOSS)/PROFIT

The Group's operating (loss)/profit is arrived at after charging the following items:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Auditors' remuneration	718	718	603
Amortisation of land use rights	—	—	5
Depreciation of property, plant and equipment	3,958	4,457	9,341
Operating lease charges on:			
- land and buildings	2,358	2,182	2,262
- computer equipment	2,927	5,361	17,507
Development costs (note (i))	15,464	12,835	37,253
Staff costs (note (ii))	28,808	26,812	68,935
Net foreign exchange losses	152	212	3,710
Write off of property, plant and equipment	517	795	—
Loss on disposal of property, plant and equipment	112	466	20
Impairment on receivables	2	416	541

Notes:

(i) Development costs mainly comprise depreciation of property, plant and equipment of RMB896,000, RMB164,000 and RMB100,000 for the years ended 31 December 2005, 2006 and 2007, respectively, and staff costs of RMB13,958,000, RMB12,171,000 and RMB36,268,000 for the years ended 31 December 2005, 2006 and 2007, respectively, which are also included in the total amounts disclosed separately above for each of these types of expenses.

The Group did not capitalise any development costs for the years ended 31 December 2005, 2006 and 2007.

(ii) Breakdown of staff costs, including directors' remuneration, is as follows:

	The Group		
	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Wages, salaries and bonus	24,043	22,565	59,946
Welfare, medical and other benefits	2,177	1,989	5,457
Contribution to pension plans	2,588	2,258	3,532
	28,808	26,812	68,935

9. FINANCIAL RESULTS AND FINANCIAL ASSETS AND LIABILITIES BY CATEGORY OF FINANCIAL INSTRUMENTS

Financial results by category

Net gains/(losses) from financial assets and financial liabilities by category of financial instruments are set out below:

	The Group			The Company		
	2005	2006	2007	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Available-for-sale financial asset	54	—	—	—	—	—
Financial assets at fair value through profit or loss held for trading	—	383	106	—	—	—
Loans and receivables	(2)	(416)	(541)	—	—	—
Cash and cash equivalents and term deposits with initial terms of over three months	392	614	7,008	—	—	3,584
Net amounts reported in the consolidated income statements	444	581	6,573	—	—	3,584

Financial assets by category

The carrying amount of the Group's financial assets by category of financial instruments included in the consolidated balance sheets and the headings in which they are included as follows:

	The Group			The Company		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Non-current asset						
Available-for-sale financial asset	4,000	4,000	4,000	—	—	—
Current assets						
Financial assets at fair value through profit or loss held for trading						
- Investment in trading securities	4,599	851	—	—	—	—
Loans and receivables						
- Trade and other receivables	9,953	40,354	67,295	—	—	5,428
- Amounts due from related parties	5,530	11,357	8,832	1,453	1,453	—
- Amount due from a subsidiary	—	—	—	—	—	225,052
- Term deposits with initial terms of over three months	—	—	50,000	—	—	—
- Cash and cash equivalents	15,277	66,322	1,651,380	—	—	1,317,532
	39,359	122,884	1,781,507	1,453	1,453	1,548,012

Financial liabilities by category

The carrying amount of the Group's financial liabilities by category of financial instruments included in the consolidated balance sheets and the headings in which they are included are as follows:

	The Group			The Company		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Current liabilities						
Financial liabilities measured at amortised cost						
- Trade and other payables	14,042	28,116	39,929	—	—	7,402
- Amounts due to related parties	2,156	725	76	—	—	—
- Amounts due to subsidiaries	—	—	—	—	—	2,967
	16,198	28,841	40,005	—	—	10,369

10. REMUNERATION OF DIRECTORS AND FIVE HIGHEST PAID INDIVIDUALS

(i) **Directors' remuneration**

The aggregate amount of remuneration paid and payable to the directors of the Company by the Group during the Relevant Years are as follows:

	Year ended 31 December 2005				
	Fees	**Salaries and allowances**	**Discretionary bonus**	**Contribution to pension plans**	**Total**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors					
Mr Liu Dejian	—	303	—	—	303
Mr Liu Luyuan	—	132	—	4	136
Mr Zheng Hui	—	58	—	4	62
Mr Chen Hongzhan	—	173	—	4	177
Non-executive directors					
Mr Lin Dongliang	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—
Independent non-executive directors					
Mr Chao Guowei, Charles	—	—	—	—	—
Mr Lee Kwan Hung	—	—	—	—	—
Mr Liu Sai Keung, Thomas	—	—	—	—	—
	—	666	—	12	678

	Year ended 31 December 2006				
	Fees	Salaries and allowances	Discretionary bonus	Contribution to pension plans	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors					
Mr Liu Dejian	—	874	—	—	874
Mr Liu Luyuan	—	131	—	4	135
Mr Zheng Hui	—	65	—	—	65
Mr Chen Hongzhan	—	209	—	4	213
Non-executive directors					
Mr Lin Dongliang	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—
Independent non-executive directors					
Mr Chao Guowei, Charles	—	—	—	—	—
Mr Lee Kwan Hung	—	—	—	—	—
Mr Liu Sai Keung, Thomas	—	—	—	—	—
	—	1,279	—	8	1,287

	Year ended 31 December 2007				
	Fees	Salaries and allowances	Discretionary bonus	Contribution to pension plans	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors					
Mr Liu Dejian	—	817	—	—	817
Mr Liu Luyuan	—	407	—	4	411
Mr Zheng Hui	—	151	—	4	155
Mr Chen Hongzhan	—	328	—	6	334
Non-executive directors					
Mr Lin Dongliang	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—
Independent non-executive directors					
Mr Chao Guowei, Charles	38	—	—	—	38
Mr Lee Kwan Hung	50	—	—	—	50
Mr Liu Sai Keung, Thomas	—	—	—	—	—
	88	1,703	—	14	1,805

During the Relevant Years, no emoluments were paid by the Group to any of the directors as an inducement to join or upon joining the Group or as compensation for loss of office and none of the directors has waived or agreed to waive any emoluments.

(ii) **Five highest paid individuals**

The five highest paid individuals in the Group consisted of two, one and two directors of the Company for the years ended 31 December 2005, 2006 and 2007, respectively, were directors of the Company whose emoluments were included in the disclosure in note 10(i) above. The emoluments of the remaining three, four and three highest paid individuals for the years ended 31 December 2005, 2006 and 2007, respectively, were as follows:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Salaries and allowances	1,251	2,244	1,859
Discretionary bonus	—	—	—
Contribution to pension plans	—	—	—
	1,251	2,244	1,859

The remuneration paid to each of the above non-director individuals during the years ended 31 December 2005, 2006 and 2007 fell within the band of nil to RMB1,000,000.

During the Relevant Years, no emoluments were paid by the Group to any of the five highest paid employees as an inducement to join or upon joining the Group or as compensation for loss of office.

11. INCOME TAX (CREDIT)/EXPENSE

The major components of income tax (credit)/expense for the Relevant Years are as follows:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Current tax			
- PRC (note (i))	—	1,446	51,786
- USA (note (ii))			
Tax for the year	356	1,267	601
Over-provision in prior years	—	—	(290)
	356	2,713	52,097
Deferred income tax (note 27)	(2,077)	5,845	147
Income tax (credit)/expense	(1,721)	8,558	52,244

Notes:

(i) PRC enterprise income tax ("EIT") is calculated at the applicable rates in accordance with the relevant laws and regulations in the PRC.

TQ Digital is a foreign-invested enterprise and was approved to be a hi-tech enterprise located in high technology development zone on 29 July 2005. Pursuant to the Circular on Some Preferential Policies for the Enterprise

Income Tax (關於企業所得稅若干優惠政策的通知) issued by the Ministry of Finance (財政部) and the State of Administration of Taxation (國家稅務總局) on 29 March 1994, TQ Digital is entitled to a preferential income tax rate of 15%. The qualification of hi-tech enterprise is subject to review once every two years and TQ Digital continued to be recognised as a hi-tech enterprise on 16 August 2007. On 25 December 2003, TQ Digital was approved to be a software enterprise. Pursuant to the Circular on the Tax Policies for Encouraging the Development of Software and Integrated Circuit Industries (關於鼓勵軟件產業和集成電路產業發展有關稅收政策問題的通知) issued by the Ministry of Finance (財政部), the State Administration of Taxation (國家稅務總局) and the General Administration of Customs (海關總署) on 22 September 2000, TQ Digital is entitled to tax benefits of tax exemption for two years starting from the first year of profitable operations after offsetting prior year tax losses, followed by 50% tax reduction for three years. 2003 was the first profitable year for TQ Digital. Accordingly, the EIT tax rate applicable to TQ Digital during the Relevant Years was 7.5%.

NetDragon (Fujian) continued to be recognised as a hi-tech enterprise located in high technology industrial development zone on 9 November 2004. Pursuant to the Circular on Some Preferential Policies for the Enterprise Income Tax (關於企業所得稅若干優惠政策的通知) as mentioned in the previous paragraph, NetDragon (Fujian) was entitled to paying EIT at the reduced tax rate of 15% for 2005 and 2006. Pursuant to a notice issued by a government authority (福建省科學技術廳) on 16 August 2007, NetDragon (Fujian) continued to be recognised as a hi-tech enterprise and is thereby subject to EIT tax rate of 15% for 2007.

NetDragon (Shanghai) is subject to EIT tax rate of 33% during the Relevant Years.

No provision for EIT has been made for the year ended 31 December 2005 as TQ Digital, NetDragon (Fujian) and NetDragon (Shanghai) did not derive assessable income in the PRC for 2005.

On 16 March 2007, the PRC promulgated the Law of the PRC on Enterprise Income Tax (the "New Tax Law") by order No. 63 of the president of the PRC, which became effective on 1 January 2008. According to the New Tax Law, the income tax rate applicable to the Group's PRC subsidiaries is unified at 25%. According to the Circular of State Administration of Taxation Concerning Pre-Payment Issues Relevant to Enterprise Income Tax (國家稅務總局關於企業所得稅預繳問題的通知) issued by the State Administration of Taxation on 31 January 2008, TQ Digital and NetDragon (Fujian) which were recognised as hi-tech enterprises prior to 1 January 2008 shall provisionally subject to the EIT tax prepayment rate of 25%, pending further recognition in accordance with the New Tax Law.

(ii) The USA income tax rates applicable to the Group are 34% for federal tax and 8.84% for state income tax during the Relevant Years.

(iii) The Group is not subject to any taxation under the jurisdictions of the Cayman Islands and the British Virgin Islands ("BVI") during the Relevant Years. Provision for Hong Kong profits tax is not made as the Group has not derive any assessable profits in Hong Kong during the Relevant Years.

A reconciliation of income tax (credit)/expense and accounting (loss)/profit at applicable tax rate is as follows:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
(Loss)/Profit before income tax	(30,921)	51,543	427,081
Tax calculated at domestic tax rates applicable to profits in the respective jurisdictions	(3,848)	8,426	65,721
Tax exemptions	—	(2,790)	(30,917)
Tax effect of non-taxable income	(35)	(81)	(2,229)
Tax effect of non-deductible expenses	2,194	2,917	19,991
Over-provision in prior years	—	—	(290)
Others	(32)	86	(32)
Income tax (credit)/expense	(1,721)	8,558	52,244

12. DIVIDENDS

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Special dividends paid during the year	—	—	79,069
Proposed final dividend of RMB0.4 per share	—	—	216,093
	—	—	295,162

Special dividends were declared and paid by the Company and NetDragon (BVI) prior to the reorganisation of the Group:

(a) On 3 February 2007, NetDragon (BVI) declared a special dividend of RMB44,839,000 to its then equity holders.

(b) On 20 June 2007, NetDragon (BVI) declared a special dividend of RMB34,230,000 to the Company. On the same date, the Company declared the same amount of dividend to its equity holders who are effectively the then equity holders of NetDragon (BVI).

The dividend rates and the number of shares ranking for special dividends are not presented as such information is considered not meaningful for the purpose of this report.

The proposed final dividend was determined based on the number of shares as at the date of the results announcement of the Group for the year ended 31 December 2007, taking into account the share redemption of 15,858,500 shares after the year end (note 31). The proposed final dividend for the year ended 31 December 2007 had been approved by the Company's shareholders at the annual general meeting held on 28 April 2008 and therefore, has not been recognised as a liability at the balance sheet date.

13. (LOSS)/EARNINGS PER SHARE

The calculation of (loss)/earnings per share attributable to the equity holders of the Company is calculated based on consolidated (loss)/profit attributable to the equity holders of the Company of each of the Relevant Years and the weighted average number of 350,912,060, 350,912,060 and 440,953,947 shares for the years ended 31 December 2005, 2006 and 2007, respectively, as adjusted to reflect the shares issued for capitalisation as detailed in note 23(viii).

Subsequent to the year ended 31 December 2007, the Company repurchased of own shares through purchase on the Stock Exchange as detailed in note 31, which reduced the number of issued ordinary shares.

Diluted earnings per share for the Relevant Years have not been presented as there were no dilutive potential shares.

14. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Leasehold improvements	Computer and office equipment	Motor vehicles	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Cost:					
At 1 January 2005	—	892	17,019	956	18,867
Additions	—	13	3,273	135	3,421
Disposals	—	—	(1,082)	(337)	(1,419)
At 31 December 2005 and 1 January 2006	—	905	19,210	754	20,869
Additions	—	680	13,698	1,339	15,717
Disposals	—	—	(4,098)	(619)	(4,717)
At 31 December 2006 and 1 January 2007	—	1,585	28,810	1,474	31,869
Additions	1,505	469	41,751	3,779	47,504
Disposals	—	—	(34)	—	(34)
At 31 December 2007	1,505	2,054	70,527	5,253	79,339
Accumulated depreciation:					
At 1 January 2005	—	239	3,258	223	3,720
Charge for the year	—	169	3,635	154	3,958
Disposals	—	—	(360)	(187)	(547)
At 31 December 2005 and 1 January 2006	—	408	6,533	190	7,131
Charge for the year	—	262	4,059	136	4,457
Disposals	—	—	(2,624)	(306)	(2,930)
At 31 December 2006 and 1 January 2007	—	670	7,968	20	8,658
Charge for the year	14	440	8,201	686	9,341
Disposal	—	—	(4)	—	(4)
As at 31 December 2007	14	1,110	16,165	706	17,995
Net carrying amount:					
As at 31 December 2005	—	497	12,677	564	13,738
As at 31 December 2006	—	915	20,842	1,454	23,211
As at 31 December 2007	1,491	944	54,362	4,547	61,344

The Group's buildings are situated in the PRC and held under long-term lease.

15. LAND USE RIGHTS

The Group's interests in land use rights represent prepaid operating lease payments in respect of land located in the PRC and their carrying amount are analysed as follows:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Carrying amount at 1 January	—	—	—
Additions	—	—	1,179
Amortisation for the year	—	—	(5)
Carrying amount at 31 December	—	—	1,174

The land use rights were acquired in 2007 with lease period of 55 years and are amortised over their lease period.

16. INTEREST IN AN ASSOCIATE

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Unlisted equity investment, at cost	430	—	—

The associate has not carried out any business activity since its incorporation in 2005 and it was dissolved in 2006. Particulars of the associate at 31 December 2005 are as follows:

Name	Particulars of issued capital	Place of incorporation	Percentage of interest held by the Group	Principal activity
福州易凱瑞網路資訊技術有限公司	RMB1,000,000	PRC	43%	Dormant

The following table illustrates the summarised financial information of the associate extracted from its management accounts for the year ended 31 December 2005:

	RMB'000
Assets	1,000
Liabilities	—
Revenue	—
Profit	—

17. SUBSIDIARIES

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Investments in subsidiaries			
Unlisted shares, at cost	—	—	167,871
Amount due from a subsidiary	—	—	225,052

The amounts due are unsecured, interest-free and repayable on demand. The directors consider that the carrying amounts of the balances approximate its fair value.

Particulars of the subsidiaries are as follows:

Name	Place and date of incorporation/ establishment and kind of legal entity	Particulars of issued and fully paid share capital/ registered capital	Effective interest held by the Company	Principal activities	Name of the statutory auditors for 2005, 2006 and 2007
Interests held directly					
NetDragon Websoft Inc.	Incorporated on 8 January 2003 in the BVI, limited liability company	US$222,203.93	100%	Investment holding	No statutory audit requirements
Interests held indirectly					
福建網龍計算機網絡信息技術有限公司 (Fujian NetDragon Websoft Co., Ltd.*), formerly known as 福州網龍計算機網絡信息技術有限公司	Established on 25 May 1999 in the PRC, limited liability company	RMB10,000,000	99.36% Δ	Operation of online games	福建華興有限責任會計師事務所 (Fujian Huaxing Certified Public Accountants Ltd.)
Fujian TQ Digital Inc (福建天晴數碼有限公司), formerly known as Fujian TQ Digital Ind (福建天晴數碼有限公司) and Fuzhou TQ Digital Ind (福州天晴數碼有限公司)	Established on 28 February 2003 in the PRC, wholly-owned foreign enterprise #	RMB345,000,000	100%	Development of online games and licensing and servicing of the developed games	福建華興有限責任會計師事務所 (Fujian Huaxing Certified Public Accountants Ltd.)
上海天坤數碼科技有限公司 (Shanghai Tiankun Digital Technology Ltd.*)	Established on 20 December 2004 in the PRC, limited liability company	RMB1,000,000	99.36% Δ	Provision of support services to a group company in the PRC	上海驍天誠會計師事務所有限公司 (Shanghai Xiao Tian Cheng Certified Public Accountants Co., Ltd.)

Name	Place and date of incorporation/ establishment and kind of legal entity	Particulars of issued and fully paid share capital/ registered capital	Effective interest held by the Company	Principal activities	Name of the statutory auditors for 2005, 2006 and 2007
NetDragon Websoft Inc.	Incorporated on 10 July 2003 in the USA, domestic stock corporation	US$600,000	100%	Provision of support services to a group company in the USA (note)	No statutory audit requirements
NetDragon Websoft (Hong Kong) Limited (網龍香港有限公司)	Incorporated on 28 June 2007 in Hong Kong, limited liability company	HK$1	100%	Operation of online games	W.H. Wong & Co.
Glory More Limited (展凱有限公司)	Incorporated on 31 January 2008 in Hong Kong, limited liability company	HK$1	100%	Investment holding	Not applicable
Fujian TQ Online Interactive Inc. (福建天晴在線互動科技有限公司)	Established on 18 March 2008 in the PRC, wholly-owned foreign enterprise	RMB50,000,000	100%	Development of online games and licensing and servicing of the developed games	Not applicable

Note: NetDragon (USA) was engaged in operation of online games before June 2007.

* for identification purpose only
\# converted to be a wholly-owned foreign enterprise on 28 November 2003
Δ interest existed by virtue of certain contractual arrangements as described in note 1

18. AVAILABLE-FOR-SALE FINANCIAL ASSET/INVESTMENT IN TRADING SECURITIES

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Unlisted equity investment — PRC	4,000	4,000	4,000
Unlisted debt securities — USA	4,599	851	—
	8,599	4,851	4,000
Represented by:			
Available-for-sale financial asset	4,000	4,000	4,000
Investment in trading securities	4,599	851	—
	8,599	4,851	4,000

The unlisted equity investment represents 9.5% interest in 福建楊振華851生物科技股份有限公司 which was established in the PRC. Mr Liu Dejian and Mr Zheng Hui, directors of the Company, are directors of the entity and Ms Lin Yun, a beneficial owner of the Company, has equity interest in the entity. The unlisted debt securities represent bonds and certificate of deposits issued by U.S. corporations.

The available-for-sale financial asset is denominated in RMB while the trading securities are denominated in USD.

The available-for-sale financial asset is stated at cost less impairment because the directors are of the opinion that its fair value cannot be measured reliably.

The debt securities bear interest at fixed rates ranging from 4.0% to 4.5% for the year ended 31 December 2005, from 4.2% to 4.5% for the year ended 31 December 2006, and there is no debt securities outstanding as at 31 December 2007. The debt securities as at 31 December 2005 matured between 7 April 2006 and 21 September 2007 while the debt securities as at 31 December 2006 matured between 10 May 2007 and 21 September 2007.

19. TRADE AND OTHER RECEIVABLES

	The Group			The Company		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Trade receivables *(note (i))*	1,131	6,200	26,940	—	—	—
Other receivables *(note (ii))*	2,206	18,837	6,140	—	—	3,280
Deposits and prepayments	6,616	15,317	34,215	—	—	2,148
	9,953	40,354	67,295	—	—	5,428

Notes:

(i) The ageing analysis of trade receivables at the Relevant Years, based on the invoice date, is as follows:

	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Outstanding balances with ages:			
- 30 days or below	970	5,764	22,881
- 31 - 60 days*	32	33	1,983
- 61 - 90 days*	22	24	1,876
- 91 - 180 days*	27	162	—
- 181 - 365 days*	80	144	—
- Over 365 days*	—	73	200
	1,131	6,200	26,940

* past due but not impaired

Trade receivables that are not yet past due relate to a wide range of corporation partners, sales distributors and distribution partners for whom there was no recent history of default. Trade receivables that were past due but not impaired relate to a number of independent corporation partners, sales distributors and distribution partners that have a good track record with the Group and the Company. Based on past experience, management believes that no impairment allowance is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group and the Company do not hold any collateral over these balances.

The Group allows an average credit period ranging from 30 days to 45 days to its trade debtors but the trade debtors usually settle the outstanding balance within 30 days from the billing date.

(ii) Included in other receivables as at 31 December 2006 was a balance of RMB14,500,000 placed with a PRC entity, Guolun Holdings Limited (高能控股有限公司), an independent third party, for providing asset management services to the Group pursuant to an agreement signed on 12 December 2006 (the "Asset Management Agreement"). On 27 May 2007, TQ Digital entered into an agreement with Mr Liu Dejian, one of the executive directors and beneficial owner of the Company, to dispose its rights underlying the Asset Management Agreement at a consideration of RMB14.5 million. The director is required to settle the consideration within 30 days from the date of the agreement. The balance was settled by the director on 13 June 2007 and 13 August 2007. Guolun Holdings Limited (高能控股有限公司) has not utilised any amounts under the Asset Management Agreement to purchase any investments during the term of the Asset Management Agreement.

(iii) Trade and other receivables are interest-free and unsecured. Other receivables are not past due or impaired as at year end date. The directors considered that the carrying amounts of trade and other receivables approximate their fair values because of their short maturities.

(iv) Included in trade and other receivables are the following amounts denominated in a currency other than RMB:

	The Group			The Company		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
HK Dollars	—	—	5,560	—	—	5,428
US Dollars	1,121	2,125	7,929	—	—	—

20. TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

The effective interest rates of the term deposits of the Group with initial term of over three months for the year ended 31 December 2007 was 3.42% per annum (2005 and 2006: Nil).

As at 31 December 2007, all the Group's term deposits are denominated in RMB with initial term of over three months.

21. CASH AND CASH EQUIVALENTS

	The Group			The Company		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Cash on hand and at bank	14,018	60,810	1,650,102	—	—	1,317,532
Cash deposited with an online payment service provider *(note (i))*	1,259	5,512	1,278	—	—	—
	15,277	66,322	1,651,380	—	—	1,317,532

Notes:

(i) Cash deposited with the online payment service provider could be readily withdrawn by the Group. In prior year, the accounts maintained with this online payment service provider were held on trust by the directors of NetDragon (USA) on behalf of the Group for the exclusive use of accepting online payment from customers. During the 2nd half of 2007, the Group has set up a corporate account with the online payment service provider which is owned by and under the name of NetDragon (USA) and all the funds held by the directors of NetDragon (USA) on behalf of NetDragon (USA) have been transferred to the corporate account.

(ii) As at 31 December 2005, 31 December 2006 and 31 December 2007, cash and cash equivalents of the Group denominated in RMB amounted to RMB7,164,000, RMB23,553,000 and RMB286,403,000. The conversion of RMB into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

(iii) Cash deposited with banks bear interest at effective interest rates ranging from 0.6% to 3.7% per annum during the Relevant Years. Cash deposited with the online payment service provider bears interest at effective interest rates ranging from 2.5% to 5.7% per annum during the Relevant Years.

(iv) Included in cash and cash equivalents are the following amounts denominated in a currency other than RMB:

	The Group			The Company		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
HK Dollars	—	—	1,318,539	—	—	1,317,532
US Dollars	8,113	42,769	45,958	—	—	—
Japanese Yens	—	—	480	—	—	—

(v) The directors consider that the carrying amounts of cash equivalents approximate their fair values.

22. TRADE AND OTHER PAYABLES

	The Group			The Company		
	2005	**2006**	**2007**	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Trade payables *(note (i))*	107	83	500	—	—	—
Accrued staff costs	4,674	5,515	5,789	—	—	—
Value added tax payables and other tax payables	3,061	9,794	5,333	—	—	—
Other payables and accrued charges	6,878	13,925	15,288	—	—	7,402
Deferred income	2,383	8,593	18,352	—	—	—
	17,103	37,910	45,262	—	—	7,402

Notes:

(i) The ageing analysis of trade payables at the Relevant Years, based on the invoice date, is as follows:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Outstanding balances with ages:			
- Within 90 days	26	1	500
- 91 - 180 days	—	—	—
- 181 - 365 days	1	1	—
- Over 365 days	80	81	—
	107	83	500

(ii) The directors consider that the carrying amounts of trade and other payables approximate their fair values.

(iii) Included in trade and other payables are the following amounts denominated in a currency other than RMB:

	The Group			The Company		
	2005	2006	2007	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
HK Dollars	—	—	7,301	—	—	7,301
US Dollars	7,769	17,845	809	—	—	101

23. SHARE CAPITAL

	Share capital				
	Number of common shares of US$0.01 each	Number of preferred shares of US$0.01 each	Total number of shares of US$0.01 each	Nominal value	
				US$	*RMB'000*
Authorised:					
At the date of incorporation and at 31 December 2005 and 2006 *(note (i))*	50,000,000	3,000,000	53,000,000	530,000	4,388
Increase in authorised share capital *(note (iii))*	450,000,000	27,000,000	477,000,000	4,770,000	36,740
Increase in authorised share capital *(note (vii))*	500,000,000	(30,000,000)	470,000,000	4,700,000	34,643
At 31 December 2007	1,000,000,000	—	1,000,000,000	10,000,000	75,771
Issued:					
At the date of incorporation *(note (i))*	1	—	1	—	—
Issue of new shares *(note (ii))*	14,878,936	2,666,666	17,545,602	175,456	1,453
At 31 December 2005, 2006 and at 1 January 2007	14,878,937	2,666,666	17,545,603	175,456	1,453
Issue of new shares *(note (iv))*	4,674,790	—	4,674,790	46,748	360
Issue of new shares *(note (v))*	19,553,727	2,666,666	22,220,393	222,204	1,693
Conversion of preferred shares to common shares *(note (vi))*	5,333,332	(5,333,332)	—	—	—
Issue of new shares *(note (viii))*	399,967,074	—	399,967,074	3,999,671	29,481
Issue of new shares *(note (ix))*	95,600,000	—	95,600,000	956,000	7,046
Issue of new shares *(note (x))*	16,200,000	—	16,200,000	162,000	1,194
Repurchase and cancellation of shares *(note (xi))*	(116,500)	—	(116,500)	(1,165)	(8)
At 31 December 2007	556,091,360	—	556,091,360	5,560,914	41,219

Notes:

(i) The Company was incorporated on 29 July 2004 with an authorised share capital of US$530,000 divided into 50,000,000 common shares of US$0.01 each and 3,000,000 preferred shares of US$0.01 each. Upon incorporation, one common share was allotted and issued at par to a shareholder.

(ii) On 15 December 2004, 14,878,936 common shares of US$0.01 each and 2,666,666 preferred shares of US$0.01 each were issued and allotted at par value.

(iii) On 1 March 2007, the authorised share capital of the Company was increased from US$530,000 divided into 50,000,000 common shares of US$0.01 each and 3,000,000 preferred shares of US$0.01 each to US$5,300,000 divided into 500,000,000 common shares of US$0.01 each and 30,000,000 preferred shares of US$0.01 each by issuing additional 450,000,000 common shares of US$0.01 each and 27,000,000 preferred shares of US$0.01 each.

(iv) On 26 March 2007, an aggregate of 4,674,790 common shares of US$0.01 each were allotted and issued at par by the Company.

(v) On 18 May 2007, in consideration for the shareholders of NetDragon (BVI) transferring the entire issued share capital in NetDragon (BVI), the immediate holding company of TQ Digital and NetDragon (USA), to the Company, an aggregate of 19,553,727 common shares of US$0.01 each and 2,666,666 preferred shares of US$0.01 of the Company were allotted and issued at par to the shareholders of NetDragon (BVI) (the "Shares Swap"). The total number of new shares issued by the Company is identical to the total number of shares of NetDragon (BVI) and the total number of shares of the Company in issue on that date.

(vi) On 15 October 2007, 5,333,332 preferred shares of US$0.01 each of the Company were converted into 5,333,332 common shares of US$0.01 each.

(vii) On 15 October 2007, the authorised share capital of the Company decreased from US$5,300,000 to US$5,000,000 by the cancellation of 30,000,000 preferred shares and then the authorised share capital of the Company increased from US$5,000,000 to US$10,000,000 by the creation of 500,000,000 shares of US$0.01 each.

(viii) Pursuant to the written resolutions of the Company passed on 15 October 2007, 399,967,074 shares of the Company were allotted and issued, credited as fully paid at par of US$0.01 each to the then shareholder of the Company, by the capitalisation of the sum of US$3,999,671 (equivalent to RMB29,481,000) from the share premium account. Such allotment and capitalisation were conditional on the share premium account being credited as a result of the new shares issued in connection with the listing of the Company's shares on the Stock Exchange.

(ix) On 1 November 2007, 95,600,000 new shares of US$0.01 each of the Company were issued to the public by way of international placing at HK$13.18 (equivalent to approximately RMB12.45) each. The gross proceeds received from the issue of the 95,600,000 new shares amounted to HK$1,260,000,000 (equivalent to RMB1,190,600,000). Part of the proceeds amounting to RMB7,046,000 was recorded as share capital, and the remaining balance proceeds of RMB1,183,554,000 was recorded in the share premium account. The shares of the Company were listed on the Stock Exchange on 2 November 2007.

(x) On 9 November 2007, the over-allotment option was exercised. 16,200,000 new shares of US$0.01 each of the Company were issued to the public by way of placement at HK$13.18 (equivalent to approximately RMB12.45) each. The gross proceeds received from the issue of the 16,200,000 new shares amounted to HK$213,516,000 (equivalent to RMB201,753,000). Part of the proceeds amounting to RMB1,194,000 was recorded as share capital, and the remaining balance proceeds of RMB200,559,000 was recorded in the share premium account.

(xi) The Company repurchased 116,500 of its own shares through purchase on the Stock Exchange during the year ended 31 December 2007. The shares have been cancelled upon being recognised. The total amount to acquire the shares was approximately HK$1.7 million (equivalent to RMB1.6 million) which have been deducted from the shareholder's equity.

24. SHARE OPTION SCHEME

On 15 October 2007, the share option scheme of the Company (the "Scheme") was adopted and complied with the requirements of the Rules governing the Listing of Securities on GEM regarding share option scheme of a company.

The Company operates the Scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Eligible participants of the Scheme include executive directors, non-executive directors, employees, shareholders, suppliers, customers, consultants, advisers, other service providers, and joint venture partners, business or strategic alliance partners. The Scheme became effective on 15 October 2007 and, unless otherwise cancelled or amended will remain in force for 10 years from that date.

The maximum number of the Company's shares which may be issued upon exercise of all options to be granted under the Scheme and any other scheme of the Company shall not in aggregate exceed 10% of the issued share capital of the Company as at the date of listing of the Company's shares on the Stock Exchange. The Scheme mandate limit may be refreshed by the shareholders in general meeting from time to time provided always that the Scheme mandate limit so refreshed must not exceed 10% of the total number of shares in issue as at the date of approval of such refreshment by the shareholders in general meeting.

Notwithstanding any other provisions of the Scheme, the maximum number of the Company's shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme and any other scheme of the Company must not in aggregate exceed 30% of the total number of shares in issue from time to time.

Share options granted to a director, chief executive, management shareholder or substantial shareholder of the Company, or to any of their respective associates (including a discretionary trust whose discretionary objects include a director, chief executive, management shareholder or substantial shareholder) are subject to approval in advance by the independent non-executive directors (excluding an independent non-executive director who is the grantee of the options). In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their respective associates (including a discretionary trust whose discretionary objects include a director, chief executive, management shareholder or substantial shareholder), in excess of 0.1% of the shares of the Company in issue at any time and with an aggregate value (based on the closing price of the Company's shares as stated in the daily quotation sheets issued by the Stock Exchange at the date of the grant) in excess of HK$5 million, within any 12-month period, are subject to shareholders' approval in advance in a general meeting.

The offer of a grant of share options may be accepted within 28 days from the date of the offer, upon payment of a nominal consideration of HK$1 in total by the grantee. The exercise period of the share options granted is determinable and notified by the directors, and may commerce on a date after the date upon which is granted but shall not be later than 10 years from the date of grant.

The exercise price of the share options must be at least the highest of (i) the nominal value of an ordinary share on the date of grant; (ii) the closing price of the Company's shares as stated in the daily quotations sheet of the Stock Exchange on the date of the offer of the share options; and (iii) the average closing price of the Company's shares as stated in the daily quotations sheet of the Stock Exchange for the five trading days immediately preceding the date of the offer.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

No share options have been granted since the adoption of the Scheme and the Company had no share options outstanding at 31 December 2007.

25. RESERVES

Details of the movements on the Group's reserves are set out in the consolidated statements of changes in equity on page I-7.

(a) **Company**

	Share premium account	Contributed surplus	Capital redemption reserve	Translation reserve	Dividend reserve	Retained profit	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
At the date of incorporation and at 31 December 2005 and 2006, and at 1 January 2007	—	—	—	—	—	—	—
Exchange difference arising on translation	—	—	—	(11,597)	—	—	(11,597)
Profit for the year	—	—	—	—	—	216,482	216,482
Total recognised income and expense for the year	—	—	—	(11,597)	—	216,482	204,885
Arising from reorganisation *(note)*	—	166,178	—	—	—	—	166,178
Issue of new shares upon listing *(note 23(ix))*	1,183,554	—	—	—	—	—	1,183,554
Issue of new shares upon capitalisation issue *(note 23(viii))*	(29,481)	—	—	—	—	—	(29,481)
Issue of new shares upon exercise of over-allotment options *(note 23(x))*	200,559	—	—	—	—	—	200,559
Share issue expenses	(59,839)	—	—	—	—	—	(59,839)
Repurchase and cancellation of shares *(note 23(xi))*	(1,561)	—	8	—	—	(8)	(1,561)
Proposed final dividend *(note 12)*	—	—	—	—	216,093	(216,093)	—
At 31 December 2007	1,293,232	166,178	8	(11,597)	216,093	381	1,664,295

Note: Contributed surplus of the Company represents the difference between the investment costs of NetDragon (BVI) and the nominal value of the shares issued by the Company pursuant to the Shares Swap as detailed in note 23(v).

The profit attributable to shareholders is dealt with in the financial statements of the Company to the extent of RMB216,482,000 for the year ended 31 December 2007 (2006 and 2005: Nil).

(b) **Group**

(i) *Share premium*

In November 2003, an aggregate of 2,666,666 preferred shares of US$0.01 each of NetDragon (BVI) were allotted and issued at a consideration of US$2 million to new investors of NetDragon (BVI), which give rise to a share premium of RMB16,267,000.

On 10 January 2007, an aggregate of 2,200,000 common shares of US$0.01 each of NetDragon (BVI) were allotted and issued at a consideration of US$4.14 per share to the new investors of NetDragon (BVI), giving rise to additional share capital to the Group (the share capital of the Group before the Shares Swap taking place on 18 May 2007 represented the share capital of NetDragon (BVI)) of US$22,000 (equivalent to approximately RMB170,000) and share premium of US$9,086,000 (equivalent to approximately RMB69,984,000). As at 31 December 2006, capital of approximately RMB21,755,000 was received in advance from certain of the new investors.

The details of the capitalisation of reserves, placement of new shares upon listing and the exercise of over-allotment option are set out in note 23(viii) to (x).

Under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands (the "Companies Law"), the share premium account can be applied by the Company subject to the provisions, if any, of its memorandum and articles of association in (a) paying distributions or dividends to members; (b) paying up unissued shares of the Company to be issued to members as fully paid bonus shares; (c) the redemption and repurchases of shares (subject to the provisions of section 37 of the Companies Law); (d) writing-off the preliminary expenses of the Company; (e) writing-off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the Company; and (f) providing for the premium payable on redemption or purchase of any shares or debentures of the Company. No distribution or dividend may be paid to members out of the share premium account unless immediately following the date on which the distribution or dividend is proposed to be paid, the Company will be able to pay its debts as they fall due in the ordinary course of business.

(ii) *Capital reserve*

Capital reserve arose on combining the results and financial positions of the companies now comprising the Group using the principle of merger accounting as explained in note 1.

The Group does not have shareholding in NetDragon (Fujian) and NetDragon (Shanghai). The establishment of the Group's control over NetDragon (Fujian) and NetDragon (Shanghai) so as to obtain substantially all economic benefit from the activities is by virtue of the Structure Contracts. On this basis, their results and financial positions are consolidated with that of the Group. The combined capital of NetDragon (Fujian) and NetDragon (Shanghai) less the amount of capital of NetDragon (Fujian) shared by the minority shareholders is thereby included in capital reserve of the Group.

As at 31 December 2005 and 2006, the Share Swap (note 23(v)) had not yet taken place and the share capital of NetDragon (BVI) which was the then holding company of the Group, was included in the capital reserve of the Group. As at 31 December 2007, the Shares Swap had already taken place and accordingly, the capital reserve of the Group as at 31 December 2007 was reduced to RMB9,946,000 which only included the combined capital of NetDragon (Fujian) and NetDragon (Shanghai) less the amount of capital of NetDragon (Fujian) shared by the minority shareholders.

(iii) *Statutory reserves*

In accordance with the relevant laws and regulations in the PRC and the articles of association of NetDragon (Fujian) and NetDragon (Shanghai), NetDragon (Fujian) and NetDragon (Shanghai) are required to appropriate 10% and 5-10% of their profit after tax after setting off the accumulated losses brought forward from prior years, as determined in accordance with PRC accounting regulations, to the statutory surplus reserve (the "SSR") and the statutory public welfare fund reserve (the "SPWF") respectively. When the balance of SSR reaches 50% of the registered capital of NetDragon (Fujian) and NetDragon (Shanghai), any further appropriation is optional. The SSR may be used to make good previous years' losses, if any, and may be converted to increase paid-up capital of the respective entities, provided the remaining balance after the capitalisation is not less than 25% of the registered capital. The SPWF could be used for capital expenditure on staff welfare facilities.

No allocation to the SPWF is required for NetDragon (Fujian) and NetDragon (Shanghai) from 1 January 2006 due to the revised laws and regulations in the PRC. The unutilised SPWF of NetDragon (Fujian) as at 31 December 2005 was transferred to SSR in 2006.

In accordance with the relevant laws and regulations concerning foreign investment enterprise established in the PRC and the articles of association of TQ Digital, TQ Digital is also required to appropriate certain portion of its profits after tax after setting off the accumulated losses brought forward from prior years, as determined in accordance with PRC accounting regulations, to reserve fund and staff's and workers' bonus and welfare fund. The amount of appropriation is determined by the board of directors of TQ Digital except for the appropriation of 10% of the net profit to the reserve fund which is mandatory until the accumulated total of the fund reaches 50% of registered capital of TQ Digital. The usage of reserve fund and staff's and workers' bonus and welfare fund are similar to that of SSR and SPWF respectively.

The above reserves cannot be used for purposes other than those for which they are created and are non-distributable as cash dividends.

26. RELATED PARTY TRANSACTIONS

Except as disclosed elsewhere in the Financial Information, the Group and the Company have the following transactions with the following related parties during the Relevant Years:

(i) Name of and relationship with related parties

Name of related parties	**Relationship**
Mr Liu Dejian	Executive director and beneficial owner of the Company
Mr Liu Luyuan	Executive director and beneficial owner of the Company
Mr Liu Ming	A close family member of Mr Liu Dejian
Mr Zheng Hui	Executive director and beneficial owner of the Company
Mr Chen Hongzhan	Executive director and beneficial owner of the Company
Ms Lin Yun	Beneficial owner of the Company and key management
Mr Wu Chak Man	Beneficial owner of the Company and key management
Mr Chen Feng*	Beneficial owner of the Company and key management
Mr Wu Jialiang	Beneficial owner of the Company and key management
福建楊振華851生物工程技術研究開發有限公司	Mr Liu Dejian has equity interest in this entity

福州天亮網絡技術有限公司	Mr Zheng Hui, Mr Wu Jialiang and Mr Chen Hongzhan have equity interests in this entity
Beso Biological Research Inc.	This entity is wholly owned by a close family member of Mr Liu Dejian and Mr Liu Luyuan
DJM Holding Limited	A shareholder of the Company in which Mr Liu Dejian has equity interest
Richmedia Holdings Limited	A shareholder of the Company in which Mr Liu Luyuan has equity interest
IDG Technology Venture Investments, L.P.	A shareholder of the Company

* resigned in June 2007

(ii) Significant related party transactions during the Relevant Years

	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Rentals paid to:			
- 福建楊振華851生物工程技術研究開發有限公司	310	285	270
- Beso Biological Research Inc.	257	265	124
After-sales service fee paid to:			
- 福州天亮網絡技術有限公司	—	550	2,972
Technical service fee paid to:			
- 福州天亮網絡技術有限公司	—	168	1,696

The directors consider that all related party transactions were carried out in the ordinary course of business and on terms agreed between the parties. The above transactions, except for the rental paid to Beso Biological Research Inc., will continue after listing of the shares of the Company on the Main Board of the Stock Exchange.

(iii) Amounts due from/to related parties as at 31 December 2005, 31 December 2006 and 31 December 2007

Group

	At 1 January	At 31 December		
	2005	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Amounts due from related parties:				
- 福建楊振華851生物工程技術研究開發有限公司 (*note*)	—	—	6,891	4,197
- 福州天亮網絡技術有限公司 (*note*)	—	—	—	2,931
- DJM Holding Limited (*note*)	961	961	961	—
- Richmedia Holdings Limited (*note*)	107	107	107	—
- IDG Technology Venture Investments, L.P.	221	221	221	—
- Mr Zheng Hui (*note*)	1,585	3,243	2,361	1,695
- Ms Lin Yun	—	—	—	9
- Mr Liu Luyuan (*note*)	15	57	57	—
- Mr Wu Chak Man	1,115	912	—	—
- Mr Chen Hongzhan (*note*)	—	—	300	—
- Mr Wu Jialiang	—	—	430	—
- Mr Chen Feng	29	29	29	—
	4,033	5,530	11,357	8,832

Note: Maximum amount due from these related parties during the Relevant Years are as follows:

	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
福建楊振華851生物工程技術研究開發有限公司	—	6,891	6,891
福州天亮網絡技術有限公司	—	—	2,931
DJM Holding Limited	961	961	961
Richmedia Holdings Limited	107	107	107
Mr Zheng Hui	3,243	3,243	2,361
Mr Liu Luyuan	57	57	57
Mr Chen Hongzhan	—	300	312

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Amounts due to related parties:			
- 福建楊振華851生物工程技術研究開發有限公司	2,006	—	—
- 福州天亮網路技術有限公司	—	574	—
- Mr Liu Dejian	58	58	76
- Ms Liu Ming	8	9	—
- Ms Lin Yun	84	84	—
	2,156	725	76

Company

	At 1 January	At 31 December		
	2005	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Amounts due from related parties:				
- DJM Holding Limited (*note*)	961	961	961	—
- Richmedia Holdings Limited (*note*)	107	107	107	—
- IDG Technology Venture Investments, L.P.	221	221	221	—
- Mr Zheng Hui (*note*)	135	135	135	—
- Mr Chen Feng	29	29	29	—
	1,453	1,453	1,453	—

Note: Maximum amount due from these related parties during the Relevant Years are as follows:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
DJM Holding Limited	961	961	961
Richmedia Holdings Limited	107	107	107
Mr Zheng Hui	135	135	135

The balances are unsecured, interest-free and have no fixed term of repayment. The directors consider that the carrying amounts of the balances approximate their fair values.

All the balances due from related parties were fully settled on or before 19 March 2008.

All the balances due to related parties were fully settled on or before 15 April 2008.

(iv) Key management remuneration

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Salaries, allowances and other short-term employee benefits	1,670	2,758	2,568
Contribution to pension plans	14	14	12
	1,684	2,772	2,580

27. DEFERRED TAX ASSETS

The following are the deferred tax assets recognised by the Group and the movements thereon during the Relevant Years:

	Tax losses	Development costs	Total
	RMB'000	*RMB'000*	*RMB'000*
At 1 January 2005	3,090	879	3,969
Credited to consolidated income statement (*note (11)*)	2,023	54	2,077
At 31 December 2005 and 1 January 2006	5,113	933	6,046
Charged to consolidated income statement (*note (11)*)	(4,966)	(879)	(5,845)
At 31 December 2006 and 1 January 2007	147	54	201
Charged to consolidated income statement (*note (11)*)	(147)	—	(147)
At 31 December 2007	—	54	54

The Company had no deferred tax assets/liabilities as at 31 December 2005, 31 December 2006 and 31 December 2007.

28. CAPITAL COMMITMENTS

At the balance sheet dates, the Group had the following capital commitments:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Contracted, but not provided for:			
- acquisition of property, plant and equipment	—	2,471	2,547

The Company had no capital commitments as at 31 December 2005, 31 December 2006 and 31 December 2007.

29. OPERATING LEASE COMMITMENTS

The Group leases its office premises and certain property, plant and equipment under operating lease arrangements. At the balance sheet dates, the Group had committed to make the following future minimum lease payments in respect of non-cancellable operating leases falling due as follows:

	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Land and buildings			
Within one year	1,899	1,872	1,448
In the second to fifth years	1,888	655	2,526
	3,787	2,527	3,974
Computer equipment			
Within one year	—	754	1,304
Total			
Within one year	1,899	2,626	2,752
In the second to fifth years	1,888	655	2,526
	3,787	3,281	5,278

The Company had no operating lease commitments as at 31 December 2005, 31 December 2006 and 31 December 2007.

30. CONTINGENT LIABILITIES

The Group and the Company did not have significant contingent liabilities as at 31 December 2005, 31 December 2006 and 31 December 2007.

31. SUBSEQUENT EVENTS

Subsequent to 31 December 2007 and upto the date of this report, the Company repurchased 15,858,500 of its own shares through purchase on the Stock Exchange. The aggregate consideration paid to acquire the shares was approximately HK$193,385,000. Save as aforesaid, no other significant event took place subsequent to 31 December 2007.

32. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by the Group, the Company or any of the companies now comprising the Group in respect of any period subsequent to 31 December 2007.

Yours faithfully,
Grant Thornton
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Hong Kong